PRIME MINISTER

cc: Mr. Coles
Mr. Scholar
Mr. Walters

Have 4 p.m. We must do everything possible to meet Sheik Yamani. A lot will depend upon it. Can we not stick at $30.50 now giving a retrospective discount 0.50 after 1st April and backdate it to now? MT

OIL PRICE

I had a telephone report this evening from Mr. Lawson's office about Sheik Yamani's visit to Mr. Lawson this evening.

Sheik Yamani came with a proposition, which he was pleading with Mr. Lawson to accept. He said that a fragile deal was almost within OPEC's grasp, which depended on British co-operation. The agreement was that there would be an OPEC marker price of $29 per barrel; Nigeria would keep to $30 a barrel and Libya/ Algeria to $30.50. The OPEC production quota would be an average of 17½m barrels per day (compared with 14mbd now).

What Sheik Yamani wanted us to do was to promise to hold our price at its present level of $30.50 until the beginning of April and then reduce it by 50 cents to $30. He wanted an answer tomorrow. If we said that we would do this, he was confident that the OPEC deal would be struck and would hold. But if we said that we could not hold our price, the Nigerians would match any further reduction we made, OPEC would undercut it and prices would come spiralling down.

The problem is that, with our price above both the Nigerian price and the OPEC marker prices, our oil will not sell. Mr. Lawson concludes therefore that we cannot give Sheik Yamani an undertaking in the form which he seeks.

Mr. Lawson asks your permission to miss E Committee tomorrow morning, and during that time to have discussions with BNOC. He would then like a meeting with you, the Chancellor and the Foreign Secretary in the afternoon to discuss what answer to give to Sheik Yamani; and what answer you might send to the message which King Fahd has addressed to you today (telegram attached). The Department of Energy will circulate a piece of paper tomorrow, but will not be able to do so until Mr. Lawson has seen BNOC, i.e. until the afternoon.

/Do

Yes

Do you agree that we should arrange for you to discuss this problem with the Chancellor, the Foreign Secretary and Mr. Lawson at 4 p.m. tomorrow afternoon? You have an unoccupied hour then before you are due to leave for your regional tour.

F.E.R.B.

9 March, 1983

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MR. SCHOLAR PA

cc Mr. Butler
Mr. Coles
Sir Anthony Parsons

OIL PRICE

Sheik Yamani's suggestion that we hold our price to $30.50 now and $30 after the end of March is a Trojan Camel. If we entered into such an undertaking then we would have to adjust our sales and productions so as to support this price. Essentially we would be part of OPEC and roughly speaking in the same parlous state as Nigeria was some two months ago. We would be able to sell very little of our oil.

The economic power of OPEC has been destroyed by its own delusions of perpetual power. Now it is only a political veil loosely rigged to protect reputations and to promote narrow political interests. Even if we wanted to do a deal with them, there is no viable body to enforce it. The dramatic reductions in output required by OPEC to prop up oil prices at about $30 a barrel, are so costly to the participants that there is just no hope of enforcing it.

To please Sheik Yamani, however, we might enter into an undertaking where we are willing to hold our oil price at $30.50/$30 provided the OPEC production quotas are consistent with that price - that is to say little more than the present aggregate level of output of 14mbd and that there is an effective enforcement of this quota by some suitable system, such as fines, etc. This offer could be made in good faith knowing very well that OPEC could never deliver the conditions. But it may provide a face-saver for Yamani.

Another device would be the classic form of chiselling in cartels, deferred rebates. Yet another device is the "loyalty rebate": thus customers who bought oil at £30.50 in March would be enabled to buy a similar quantity of oil at, say, $27 or $28 in April. I do not know whether any of these transparent devices will be a sufficient veil for the reality so as to satisfy Sheik Yamani's objectives.

ALAN WALTERS
10 March 1983

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SOS/R 50|83

Note of the Secretary of State's meeting with Sheikh Ahmed Zaki Yamani, Saudi Minister of Petroleum on 9 March 1983

Also present: Mr West

Sheikh Yamani began by regretting that the Secretary of State had not been sharing the OPEC Ministers' headaches. The Secretary of State replied that the UK had been trying to help. BNOC had come under great pressure to reduce its prices immediately after the failure of the OPEC meeting in Geneva, but had not done so for some time in order to allow OPEC to redeem the situation. When it had lower prices, it had made the minimum cut - $ 3-although its customers had been asking for much more. The Nigerians had immediately under-cut this price but BNOC had not made a further reduction, in spite of great pressure.

Sheikh Yamani said that he knew how the Secretary of State felt. However, the UK shared in OPEC's problem which could become a disaster. All possible pressure had been put on the Nigerians: King Fahd had spoken to President Shagari more than once and Dikko had been recalled to Lagos for consultation; on his return, his position had been more entrenched than before. The Nigerians had a political problem in that one of the issues in their forthcoming election was whether or not they should stay in OPEC. OPEC could not afford to lose them, and nor could the UK.

However, there was no point in keeping them in OPEC unless they could be prevented from lowering their prices. All the other OPEC members had told them that they had over-reacted to BNOC's $ 3 cut,

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but everyone knew that in the past BNOC had taken their markets. They would not now admit that there was any differential between their crudes and BNOC's. The Secretary of State interjected that Sheikh Yamani knew that there was some differential and Sheikh Yamani agreed as concerns the US.

He went on to say that OPEC was hoping to settle on a marker of $ 29 with Algeria and Libya at $ 30.50 (to which they had agreed), and Nigeria at $ 30. It was also hoped that the market would allow all these prices to be increased by two instalments of 50¢ each, at which level they would be frozen for two years. However, OPEC's fear was that the UK reaction would be an immediate price reduction which the Nigerians would immediately follow. In that case, the Gulf States would have no choice but to cut the marker to $ 25 - 27 and wait for the market to react.

He said that Sheikh Ali Khalifa had told him that North Sea production in 1983 would be the same as in 1982, and he appreciated that. However, he hoped to make some highly confidential arrangements with the Secretary of State - and would rely on the Secretary of State's word - to keep the Nigerians in line during the transitional period immediately ahead. This was his Government's wish and King Fahd had sent a message to that effect to the Prime Minister. He was certain that demand for oil would shortly start to grow, and that the companies would respect an OPEC agreement which OPEC was determined to defend, and so reverse their destocking once that decision was reached. Therefore, the quota would be 17.5 mbpd on average for the year as a whole. It was only the Iranians who could not be guaranteed to respect their part in this, but their capacity was limited and they would do as much as they could. Even the Libyans would behave and not resume flooding the market with cheap oil.

The Secretary of State replied that in his judgement 17.5 mbpd would reduce rather than increase confidence in the market . Things might be different if OPEC made it clear that their output would be lower up to the Autumn. BNOC would certainly try to secure the highest price it could get for its oil, but it did have to follow the market as it was at the time. The last thing he wanted was a price war and, if OPEC were to reach agreement in the next few days, he hoped that BNOC could hold its present price in the meanwhile. Thereafter, its price would depend on two inter-related factors: the first was market sentiment and the second was the Nigerian price. He thought that BNOC could perhaps live with a smaller differential than in the past but the plain fact was that there had to be some differential. Sheikh Yamani asked whether this was so even in Europe and the Secretary of State replied in the affirmative, although he said that it could be smaller than in the US. He thought that the differential could perhaps be compressed to $ 1 or even 50¢, if the market had confidence in OPEC's agreement, but could not guarantee that since he was in no position to do so. In his view, it was just possible that BNOC could fit in with Sheikh Yamani's package at $ 29.50.

Sheikh Yamani said that such a response would provoke a price war because the Nigerians would react to it. What he was asking for was a repeat of the delay, with a promise of retrospection, that BNOC had exercised after Geneva. They should exercise their famous British patience until early or mid-April and then cut by only 50¢. The market would not respond positively to the OPEC agreement immediately but it would respond if only the UK gave it a chance. He would never ask the Secretary of State to do anything impossible or harmful but he was asking for this because he really did need the Secretary of State's help.

The Secretary of State replied that BNOC had been helpful even though it had been very difficult for them and their largest customer had walked away. Sheikh Yamani understood the UK's North Sea regime and what did he suggest BNOC should do with its oil if it could not find customers at $ 30.50? If that oil went on to the spot market the consequences for OPEC would be worst of all. Sheikh Yamani said that there were a million things the UK could do - for example, whisper in the ears of the most difficult companies such as Shell. In any case, this situation would last only for a month or so and, to avoid a price collapse, the UK could afford to lose a few thousand barrels a day for that time. Saudi Arabia was making much larger sacrifices. The Secretary of State said that of course he talked to the British oil companies but that they were free agents. It was the Nigerians who were responsible for the danger of a price collapse. The UK did not wish to make difficulties but it really was the case that he did not control North Sea prices and output. BNOC could delay for a week or so, but no longer or it would lose all its term customers and then be unable to recover them. Sheikh Yamani said that, in the oil business, that could not happen overnight.

He said that he hoped that final details of the OPEC package would be worked out on 10 March and an announcement made that day. He would be carrying the main burden of explaining it to the press.

He did not propose to fight a losing battle so his attitude would depend on the Secretary of State's response to his request. If it were positive, he would convince the market that the agreement would hold. However, if he thought that the UK, followed by the Nigerians, would start a price war his presentation would be weaker and the result would be a deep cut by the Gulf States. A great deal therefore depended on the Secretary of State's response.

The Secretary of State said that it was important that there should be no misunderstanding. He would be as helpful as possible, as he had been all along but he was notoptimistic that BNOC could do what was being asked of them. It was not a question of their taking an initiative, but of how the market would react to OPEC's package. He would consult BNOC on 10 March and let Sheikh Yamani know the outcome. He would also keep this meeting entirely confidential. He understood the burden that Sheikh Yamani had to carry but Sheikh Yamani understood that the UK had a free market system (and was clear that it was in her interest to keep it) and that there should be a differential between Nigerian and North Sea crude. Sheikh Yamani said that he also knew North Sea crude to be an indigenous European crude which other European countries would dearly like to buy on long term contracts. He hoped to see a change in the UK's free market system. He sincerely hoped to have the Secretary of State's backing.

The Secretary of State said that he was always happy to meet Sheikh Yamani and that he hoped to see him in Saudi Arabia. However, there was a difficulty at present. Sheikh Yamani replied that the difficulty was temporary and that the Secretary of State should come in April. He looked forward to hearing from him on 10 March. The

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Secretary of State said that he and BNOC would do their best to be helpful but the market realities were what they were.

J D West

J D WEST
PS/Secretary of State
Room 1237, Ext 6402

9 March 1983

cc PS/MOS
PS/PUS
Mr Guinness
Mr Wiggins
Mr Fremantle
Dr Wright

PS/Foreign Secretary
Mr Heap

PS/Chancellor

PS/Prime Minister

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